MOODY'S INVESTORS SERVICE

CREDIT OPINION
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New Issue

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City of Arlington, TX Municipal Drainage Utility System

New Issue - Moody's Upgrades to Aa1 Arlington, TX's Municipal Drainage Utility Revenue Bonds

Summary Rating Rationale

Moody's Investors Service has upgraded to Aa1 from Aa2 the rating on the City of Arlington Municipal Drainage Utility System's (TX) outstanding revenue bonds, and assigned a Aa1 to the $8.2 million Municipal Drainage Utility System Revenue Bonds, Series 2017. Post-sale, the drainage utility will have $27.4 million of debt outstanding. The outlook is stable.

The upgrade to Aa1 reflects the system's large and diverse service area though small and more limited operations characteristic of a storm water system. The rating further considers the notably above-average system liquidity position and debt service coverage levels, and modest debt profile supported by adequate legal provisions protecting bondholders.

Credit Strengths

» Gross revenue pledge

» Strong and stable debt service coverage ratios

» Above-average system liquidity

Credit Challenges

» Springing debt service reserve fund

» Additional capital needs with debt issuance expected over the near term

Rating Outlook

The stable outlook reflects the expectation that despite additional debt plans for the utility system, already-adopted rate increases through 2020 will continue to provide above-average debt service coverage ratios.

Factors that Could Lead to an Upgrade

» Reduction in the ratio of debt to operating revenues

» Strengthening of the legal structure

Factors that Could Lead to a Downgrade

» Material decrease in unrestricted reserves

» Trend of declining debt service coverage below historic levels

Key Indicators

Exhibit 1

ARLINGTON DRAINAGE UTILITY SYSTEM					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	46 years				
System Size - O&M (in $000s)	3,430				
Service Area Wealth: MFI % of US median	95.00%				
Legal Provisions					
Rate Covenant (x)	1.10x				
Debt Service Reserve Requirement	DSRF funded a less than 3 prong test or springing DSRF				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue ($000)	10,536	10,815	10,774	12,160	13,575
System Size - O&M (in $000s)	2,874	2,845	2,909	3,110	3,430
Net Funded Debt ($000)	25,365	23,981	21,867	20,502	18,482
Annual Debt Service Coverage (x)	3.03x	3.44x	3.39x	4.17x	4.57x
Cash on Hand	3288 days	3040 days	2186 days	1923 days	1940 days
Debt to Operating Revenues (x)	2.4x	2.2x	2.0x	1.7x	1.4x

Annual debt service coverage is presented as net revenues relative to debt service; the legal pledge is a first lien on gross operating revenues.
Source: Moody's Investors Service; bond ordinance and city audited financial reports

Detailed Rating Considerations

Service Area and System Characteristics: Large and Diverse Service Area in Dallas/Fort Worth Metroplex

Arlington's Municipal Drainage Utility benefits from a stable customer base. Located in Tarrant County (Aaa stable), the city of Arlington (Aa1 stable) has a large and diverse tax base characterized by residential development (nearly two thirds of the base) as well as significant industrial and commercial development, including ATT Stadium, the Dallas Cowboys and Texas Rangers sports franchises, UT Arlington, and major amusement parks, General Motors (manufacturing and finance), and healthcare establishments. The city serves as a regional employment center located equidistant from Fort Worth (Aa2 stable) and Dallas (A1 negative). New development and redevelopment in the city has bolstered growth over the past five years, bringing the city's fiscal 2017 tax base to $20.4 billion, with an expectation of continued growth for fiscal 2018. The city is mature although experiencing modest growth in population, which currently stands at approximately 383,000.

The utility collects revenues demonstrates strong collections from a diverse base of accounts. Residential and commercial rates are billed monthly through the city's utility billing system. Collection of fees is strong because failure to pay may result in discontinuance of any utility services provided by the city. Residential properties are charged a flat monthly fee while commercial properties are charged based on the amount of impervious area square footage. Residential drainage utility customers account for 96% of the customer base by count of units served, though billing is split more evenly between residential and commercial customers. The system's historical number of accounts has been relatively stable over the past five years, and at present is equal to 100,939 units. The top ten drainage utility customers accounted for a small 4% of 2016 revenues.

Debt Service Coverage and Liquidity: Very Strong Debt Service Coverage Will Slightly Moderate But Remain Healthy With New Debt Issuance

Debt service coverage and system liquidity are above average and will remain strong despite additional debt issuance plans. In 2014 the city adopted a new fee structure which includes increasing the current flat fee of $5.75 per month to $7.50 per month through

2020 in anticipation of future capital needs. In fiscal 2016, debt service coverage based on the legal security of gross revenues produced very strong coverage of 6.1 times debt service. Despite gross revenue pledge, Moody's also assesses debt service coverage based on net revenues given the operating costs of the system are expected to continue. Fiscal 2016 net revenues produced coverage that was still very healthy at 4.6 times debt service. When factoring in additional debt issuances planned for fiscal years 2018 and 2019, as well as the adopted rate increases through 2020, debt service coverage based on net revenues is expected to stay above 3.0 times debt service.

LIQUIDITY

Drainage system fiscal 2016 unrestricted liquidity is very strong $18.2 million, or 1,940 days of expenses. The nominal amount of unrestricted cash has stabilized over the past three years in the range of $16.2-$18.2 million, though expenses continue to grow, reflecting the declining trend of days cash on hand. Unrestricted reserves are expected to remain above-average over the near term.

Debt and Legal Covenants: Low Debt Profile and Adequate Legal Structure

DEBT STRUCTURE

The drainage utility's debt level relative to 2016 operating revenues is low at 1.3 times. Despite planned issuance for capital improvements in 2018 and 2019, with growth in revenues from adopted rate increases, the ratio of debt to revenues will remain low over the near term. Debt amortization is favorable with 60% of principal amortized within ten years.

DEBT-RELATED DERIVATIVES

The utility system is not a party to any derivative agreements.

LEGAL COVENANTS

The bonds are secured by first lien on gross revenues of the system; therefore, debt service payments are the highest priority in the flow of funds. Under the bond indenture, the city covenants to set rates sufficient to yield net revenues that provide 1.10 times MADS coverage. To issue additional parity debt, gross revenues must provide 1.25 times MADS coverage of current and proposed debt. The bond ordinance further requires the maintenance of a debt service reserve fund equal to maximum annual debt service should debt service coverage fall below 2.0 times. The reserve fund may be funded over a period of 60 months.

Management and Governance: System Managed by Strategic and Forward-Looking Team

Management of the city of Arlington municipal drainage department provide departmental administration within the framework of the city's council-manager form of government. Management of the system has been characterized by prudent fiscal practices and forward-looking capital planning.

Legal Security

The bonds are secured by a first lien on the gross revenues of the system.

Use of Proceeds

Proceeds of the 2017 bonds will be used for channel repair, erosion pilot programs and other improvements to the system.

Obligor Profile

The city of Arlington, TX is located in the center of the Dallas/Fort Worth Metroplex. The city encompasses 99.5 square miles and has a current population of approximately 383,000. The city operates its municipal drainage system as a self-supporting enterprise fund. The drainage utility was established in August of 1990 to protect the public health and safety from loss of life and property caused by surface water overflows and surface water stagnation.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Arlington (City of) TX Muni.Drainage Util.

Issue	Rating
Municipal Drainage Utility System Revenue Bonds, Series 2017	Aa1
Rating Type	Underlying LT
Sale Amount	$8,230,000
Expected Sale Date	06/15/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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